MINUTES
PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM
EAGAR POLICE DEPARTMENT LOCAL BOARD
Eagar Police Department Meeting Room, 174 S. Main Street, Eagar
July 16, 2015 – 7:30 A.M.

PRESENT:	Michael Sweetser, Elected Chairman Dennis Gilliam David Giddings Eva Wilson, Board Secretary
ABSENT:	Winslow McNeill, Chairman William Gleeson

ITEM #1: CALL TO ORDER

Chairman Winslow McNeill was not present and had not designated a co-chair therefore Local Board Secretary Eva Wilson called the meeting to order at 7:35 a.m. Ms. Wilson asked the members present to elect a Chair for the meeting. Dennis Gilliam moved to elect Michael Sweetser as the Chair for this meeting; David Giddings seconded; all were in favor, motion carried unanimously. 3-0

ITEM #2: OPEN CALL TO PUBLIC

None.

ITEM #3: UNFINISHED BUSINESS

None.

ITEM #4: NEW BUSINESS

A. <u>DISCUSSION AND CONSIDERATION TO APPROVE THE MINUTES OF THE PSPRS LOCAL BOARD OF JANUARY 22, 2015</u>

David Giddings moved to approve the minutes of the PSPRS Local Board of January 22, 2015. Dennis Gilliam seconded; all were in favor, motion carried unanimously. 3-0

B. <u>UPDATE REGARDING PSPRS UNFUNDED PENSION LIABILITIES AND THE FINDINGS OF THE PSPRS TASK FORCE</u>

Eagar Town Manager Tami Ryall updated the Eagar Local Board abut PSPRS by stating that people are alarmed by what is happening with PSPRS. The presentation will include how PSPRS got in this position and what they're doing to address the situation both at the fund level and legislatively and is a version of the presentation made by PSPRS representatives at a prior meeting.

The system itself is a defined benefit plan - contribute and have a guaranteed benefit – the contribution income plus the investment return equal the benefits paid plus expenses. The benefits are the liabilities and are measured in terms of present value, representing already accrued liability, normal cost, and future costs. With the benefits paid minus the expenses this equals the assets available for the benefits over time expressed based on the actuarial value which is less volatile than the actual market value of the fund. The assets divided by the benefits paid, equals the portion of the liabilities for the benefits versus what is used to spend on them or the funded ratio. If the assets are less than the benefits paid, this results in an unfunded liability that must be paid off over time.

One of the slides showed how there is an effect on liabilities from changes in assumptions such as the interest rate, wage inflation, population growth, retirement, turnover, and when there is an increase spread or smoothing, the unfunded liability decreases. There are things in the retirement system that the employer can or cannot control. Employers cannot control investment performance nor actuarial assumptions and methods as this is controlled by the fund manager and/or the PSPRS Board, and benefit provisions are set by state statute. The employers can control:

- Managing funding levels - how much we are contributing and decisions to prepay
- Managing the work force
    - Hiring members with prior service, laterals – increases the cost of the system
    - Reducing the workforce/lower payroll base – increases cost of the system as a percentage of pay
    - Disability approvals – can increase cost
    - Payroll management – with pay spiking can increase the cost

Historically, prior to PSPRS formation there were several different systems that entities participated in and PSPRS was an attempt to have a uniform and consistent system that was equitable statewide. PSPRS started in 1968, Elected Officials started in 1985 and Corrections Officers started in 1986 and those three are managed by the same fund manager. In 1997 the cancer program was added, in 2001 the Supplemental Defined Contribution Plan was added, in 2014 the Elected Officials Defined Contribution Systems was created because they essentially got rid of the Elected Official Retirement Plan (EORP) and then added the Elected Officials Disability Program in 2014 as well.

Compared with Arizona State Retirement System (ASRS) which is one system statewide with all employers the PSPRS looks like one system but really is not, and instead is a confederation of a bunch of plans that is managed by the same fund manager. So there is not a blending over all employers, the individual entitles pay the cost of their members in the system and tends to be more expensive when done that way. Differences for the actuarial methods, assumptions and demographics were compared and summarization of employee turnover, average salary, and permanent benefit increases that result in lower funding and higher rates in PSPRS.

PSPRS census data shows there are a total of 32,172 members with over 10,500 of those retired. So a very high number of retirees are being supported by a relatively low number of actives. The funding level is at 50% and the employer rate is at 41% with the Town of Eagar's being even higher at 49%. Municipal police departments are the largest composition in the PSPRS system. A graph showed the PSPRS historical returns with very few times when the actual was above the projected and several times when it was below with large low points during the 2000-2002 Tech Bubble Collapse, and 2008-2010 Great Recession. PSPRS funding levels peaked in 2001 at 129.9% and have consistently dropped to date at 50%.

Some of the factors that contributed to the drop off were the market and a re-evaluation of how the system was managed to be more realistic about the forecasts. When decisions were made to make the system more sustainable, those changes had an effect on the funding levels. The changes affecting the funding levels began with two audits in 2005 and 2007 followed by hiring of new actuaries in 2009 and performed Stochastic Projections Studies in 2010, and a legislative fix in 2011.

The first audit was part of a legislative sunset review (required of all state agencies) or a performance review and the findings found that the assumptions were too aggressive resulting in understated liabilities and contribution rates. The recommendation was to conduct a full replication audit and revise the Valuation and Experience Study reports, prompting the next audit and resulted in changes:

- Flexibility with amortization period
- Floor on employer contribution rates
- Stabilization reserve account

The Board then made changes to the actuarial cost method, amortization period and reduced the anticipated payroll growth. Thus contribution rates have dropped off with low points in 2002-2003 with a steady climb from there, (slight plateau in 2008 due to actuarial changes) and now standing at 41.4%.

The second audit confirmed that the assumptions were too aggressive aggravated by the projected Unit Credit cost method, an 8.5% investment return and no recognition of the permanent benefit increase (PBI) (cost of living adjustment – COLA), and also called out the outdated mortality rate; resulting in an understated liability and contribution rate.

The PBI (2010 Stochastic Studies) graph shows the difference of the Median Return without the COLA and the Median Compounded Return with the COLA dropping the percentage that is going into the long-term fund from an anticipated 8.5% down to below 7%. If the fund performs over a certain level they take that and put it into a pot to be divided but it's divorced from what is happening with inflation. So when the fund is doing well, the fund never benefits from doing well, it all turns into the benefit increase not linked to what is happening with the CPI or any of that. There is a 2 % loss to the fund just for the COLA. The Permanent Benefit Increase Program is very costly and needs changes to the program or advanced funded with increases in contribution rates. After additional input regarding the Stochastic Studies, Senate Bill 1609 was proposed to turn the system around.

Contribution rats are increasing with data showing this was due to asset loss, payroll declines during the economic downturn, and assumption methods. PSPRS wants to optimize the fund by avoiding the one-size-fits- all mentality by managing risk via asset allocation, and committing to diversification. If the fund had been diversified in the pool of investments prior to the Stock Market Crash of 2002 the fund would have saved 16% through the crises in

2009 , 15% during the credit crunch of 2008, and the 2009 crises loss savings would have been 8%.

The Senate Bill 1609 of 2011 changed the investment return threshold and PBI to be more in line with other systems. The PBI was now a two-tier system with PBI delay at 2 years or age 55, or age 55 removing permanent benefit COLAs for newer members of the system and allows additional employee contributions to pay down unfunded liabilities. SB 1609 also ties into four lawsuits – with the Fields decision – restores original PBI formula for members who were retired as of July 1, 2011 – upheld in the Supreme Court and an appeal and a cross-appeal filed to date. The effect on the pension was a 31% increase, 32% total, 7% increase on the PBI. The increase in liability for the Fields case to PSPRS is $1,350 million with a rate increase of 6% and funding decrease of 4% if that decision prevails. The overall pension contribution rate is at 47.51% (after phase in).

Finance Manager Katie Brady then gave a detailed report of the Eagar Police Department's contribution requirements. The normal contribution employee rate of pay is 7.65% and an additional 4% is allocated to pay down unfunded liability. The Town's normal cost requirement is 9.82% but because the great amount of unfunded liability the Town currently has, the Town has to add 34.50% to begin to fund the unfunded liabilities to get the Town to 100%. The Town chose not to participate in the phase in because the amount of money paid overtime with interest is far greater than required as a lump sum needed to participate in the phase in which requires the contribution rate to be 44.32%. Therefore, approximately a $50,000 increase is allocated towards PSPRS this fiscal year.

The accrued liability in just one fiscal year is almost $1 million due to the value of the fund and the PSPRS audit recommendations and changes to the fund, and assumption of plan performance. The Town DROP membership increased to $750,656, vested terminated members increased to $98,634 from $4,188 the previous fiscal year. The active member accrued liability this fiscal year will be $599,739 with the total accrued liability at $3.8 million. Present assets are at $1.9 million and unfunded accrued liability is also at $1.9 million an increase of over $900,000 from the previous year due to the reasons stated above. This leaves the Town's funding ratio at 49.9% with a high expectation to be funded at 100% (not to be expected for a decade or more.) There was very little change to the health benefit portion of the Town's accrued liability.

Ms. Ryall stated that in summary the fund had been managed in a way that all of the actuarial assumptions and projections were very rosy artificially lowering the unfunded liability and keeping the contribution rates lower. Once the market tanked and a series of events occurred it exposed that the plan was not being managed as conservatively as it should have been. They are turning that around but it will cost us all. It is anticipated that a new plan needs to be created for new members. This has been done for the elected officials plan.

Since June 2014 a Pension Task Force was created and has come up with a set of criteria by which they can evaluate any proposals put forward to change the system with apple-to-apple comparisons between all the legislative proposals. Once the legislative session starts, it's very hard for the legislatures to track and distinguish the differences due to the complex material and *The Yardstick* proposals will make more sense.

Discussion took place on whether the changes would be in place by July 2016, and Ms. Ryall is doubtful that will happen due to complexity of the subject and not knowing what the political will is at this time. There is also an anti-public retirement sentiment at this time especially in Arizona due to the pay spiking and double-dipping at Phoenix, which ironically isn't a member of PSPRS, but hurting and threatening all public retirement systems. The cost of employing PSPRS members is going up but the members are not benefitting from the increased costs.

Sgt. Sweetser asked for an explanation on DROP and its costs and where those costs are coming from because as an employee attending retirement meetings, PSPRS encourages employees to enter DROP because it will save the Town money since the employer is no longer paying into the system. Ms. Ryall stated it's because the employee still accrues credited service, increasing the long-term unfunded liability because there are not any contributions being made during that period, and benefits increasing for years of service.

Ms. Ryall stated that PSPRS has always been a bit mysterious and out of the lime light but these changes have brought it to the front and finally people are developing a better understanding of the plan. Sgt. Sweetser asked that Ms. Ryall make a short presentation to the PSPRS active members so they have a better understanding on why it costs the Town so much but they're not seeing any of the benefit of the cost and how and why the contribution rates change. Ms. Ryall stated that it is a very expensive plan and all members are feeling the pain of increases but there may be positive outlook in the future. Sgt. Sweetser also expressed his concern on how the ratio of active members versus retired members affect this small agency and being able to keep an advantageous formula within a small agency. Eagar has eight retired members with only seven contributing and the members within Eagar are younger and in the lower end of the pay scale. There was more discussion regarding the health of the system, the concern to employees and employers, and the ability of the system to turn around and provide the security members will depend on. Of one of the draws to municipal emergency services is the retirement, but if things do not change soon that will no longer be a draw and it will be harder to recruit and keep talent.

ITEM #5: SIGNING OF DOCUMENTS

The Minutes of January 22, 2015 were signed.

ITEM #6: ADJOURNMENT

David Giddings moved to adjourn the meeting [at 8:45 a.m.] Dennis Gilliam seconded; all were in favor, motion carried unanimously and the meeting adjourned. 3-0

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Chairman Winslow McNeill